Supreme Court of the United States

October term, 1948

No.....

ED THYS and ALBERT K. MILLER, co-partners doing business as THYS & MILLER,

Petitioners,

vs.

THE STATE OF WASHINGTON,

Respondent.

BRIEF IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF WASHINGTON

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ADDITIONAL STATEMENT OF THE CASE

This case involves the application of the Washington State retail sales tax and the Washington State business and occupation tax to the proceeds of the sales of certain hop-picking machines *manufactured in the State of Washington and sold to purchasers in the State of Washington.* (R. 2, 34, 35, 58, 84, 85, 124, 127).

It has at no time been denied by petitioners that the Washington State sales tax and the business and occupation tax properly apply to the selling price of the machines, and petitioners voluntarily paid all such taxes with respect to

that portion of the consideration involved which they considered to be the "selling price." (R. 2, 9, 16, 21, 22, 23, 24, 39, 41, 42-43, 48, 51, 71, 94, 108, 110, 111, 112). The only issue in the case was and is as to whether certain amounts paid by the purchasers as "royalties" were not in fact part of the selling price of the machines and taxable as such. (R. 2, 16, 23, 24, 39, 51, 110, 111, 112).

The contracts of sale provided that the purchasers should pay, in addition to the basic amount denominated as the selling price (which amount was actually the mere cost of each machine to petitioners—R. 58, 91, 105, 108, 112), certain "royalties" for the right to use said machine. The royalties were based upon the quantity of hops harvested, but with a minimum "royalty," usually in the amount of five hundred dollars a year, being payable each year. (R. 109, 110). The state supreme court held that the *minimum* "royalty" payments, which are payable without regard to whether or not the machines are actually used, constitute part of the selling price of the machine and are taxable as such. To quote directly from the state supreme court's opinion, so that there may be no possible question on that point:

> "Under the circumstances here shown, the so-called 'royalties', *in so far as the payments of five hundred dollars a year are concerned*, are, in effect, a part of the cost of the machine and of the right to use the same to the purchaser. *The minimum payment of five hundred dollars a year* (or some other sum) *required in any event* is, in effect, a payment simply for the right to use the machine and is not based upon any actual use thereof, ..." (Emphasis Added) (R. 120).
>
> "WE HOLD that, under the contracts whereby respondents sold the hop-picking machines within this state, the so-called 'royalties' (*referring to the payments of five hundred dollars a year, regardless of the use or*

non-use of the machine) are, for the purposes of the statutes of this state providing for the payment of a sales tax, part of the selling price of the machine and taxable as such . . . ." (Emphasis added) (R. 125)

As we have already pointed out, the machines in question were manufactured in the state of Washington for petitioners and on their order. (R. 2, 34, 35, 84, 124, 127). The manufacturing operation was financed entirely by petitioners, who maintained a bank account in this state from which the manufacture of the machines was financed. (R. 37, 49, 50, 87, 106, 107, 127). During the course of manufacture and until sold, the machines and their component parts were at all times the property of petitioners (R. 29, 34-35, 105, 127), and were required to be and were insured for their protection (R. 85, 105). One of petitioners regularly came to the state of Washington several times a year to test and inspect the machines during the course of construction. (R. 28, 88, 108). The "royalties" were collected and checked in the state of Washington by a representative (R. 61, 100, 110, 127) who is a resident of the State of Washington (R. 99).

In selling the machines, the so-called selling price (as to which tax liability is conceded) was the amount paid by the petitioners for the construction of the machines. (R. 58, 91, 105, 108, 112). In other words, the so-called selling price fixed in the contracts of sale by petitioners to their vendees actually represented the cost of the machines to petitioners (in which cost, however, was included a charge of $500 made by petitioners for engineering and supervising services (R. 106)). Aside from the charge made for engineering and supervising services, petitioners' profit on the sale of the machines came entirely in the so-called "royalties,"

with the "royalty" provision of the contracts calling for a *minimum* payment of $500 a year. And, as we have pointed out, it is those minimum royalties only that the state supreme court held to be taxable as part of the selling price of the machines, since they are payable without regard to actual use.

ARGUMENT

I. The Proceedings in the State Courts Are Not Yet Final

The court's attention is respectfully directed at the outset to the following especially significant portion of the judgment which petitioners seek to have reviewed:

> ". . . the cause [is] remanded to the superior court, *with instructions to proceed as directed by the opinion* . . ." (Emphasis added) (R. 139).

The instructions to which the express reference is made in the judgment (and which instructions are thus incorporated into the face of the judgment by necessary reference—*Clark v. Williard*, 292 U. S. 112, 78 L. Ed. 1160, 54 S. Ct. 615 (1934)), are contained in the last paragraph of the court's opinion, which paragraph reads as follows:

> "The judgment appealed from is reversed, and the cause remanded to the superior court, *with instructions to reopen the case* and, upon the record already made before the superior court *and such other evidence as may be introduced by either party or both parties*, in accordance with the views herein expressed, determine the amount of taxes due the state, for which respondents are liable, based upon the record herein, as amplified by other evidence, if any be introduced." (Emphasis added) (R. 130).

We submit that it is apparent from the face of the judgment itself that it does not have the finality that constitutes a jurisdictional prerequisite to any review of the judgment by this honorable court.

Grays Harbor Logging Co. v. Coats-Fordney Logging Co., 243 U. S. 251, 61 L. Ed. 702, 37 S. Ct. 295 (1917).

Bruce v. Tobin, 245 U. S. 18, 62 L. Ed. 123, 38 S. Ct. 7 (1917).

"It is also stated as a general rule that the judgment must be complete as well as final, and must finally dispose of all elements of the controversy . . .

" . . . And even if the judgment of the state supreme court is final in the sense that it determines the ultimate right of the plaintiff and the general principles by which it is to be measured, it is not final if it reverses the judgment of the trial court rejecting the claim and remands for new trial, although the only issue open on retrial is the amount of recovery." Robertson and Kirkham, *Jurisdiction of the United States Supreme Court*, Sec. 30.

" . . . Similarly, a state court judgment is not final when it determines all the principles governing the rights and liabilities of the parties, but refers the case to a master or court for an accounting. And even though a judgment of reversal limits the new trial to the question of the amount of damages, the judgment is not final, and is no more reviewable than one which awards a new trial on the whole case.

"Whatever means may be employed for remitting some particular issue for further proceedings, the unfinished state of the case will prevent the judgment from being final. . . ." Boskey, *"Finality of State Court Judgments Under the Federal Judicial Code,"* 43 Columbia Law Review 1002, 1009.

"A judgment or decree of the highest court of a state, reversing an inferior court and remanding the case to the lower court for a new trial or for further proceedings consistent with the judgment of the appellate court, is not a final judgment, and cannot be reviewed by the Federal Supreme Court. . . . [Citing 26 decisions to that effect] . . ." Subdivision III, entitled *"Judgment reversing, or remanding for new trial or further proceedings, generally"*, of annotation entitled *"When judgment of state court in civil cases is final for purpose for review by Supreme Court of United States"*. 89 L. Ed. 1186, 1188.

See, also:

54 Am. Jur. 820, United States Courts, Sec. 186; 36 C. J. S. 147, Federal Courts, Sec. 240; Cyclopedia of Federal

Procedure (2d ed.) Vol. 10, Sec. 4976, p. 366; Hughes Federal Practice, Vol. 5, Secs. 3191, 3192, p. 290 *et seq.*; and Simkins Federal Practice (3rd ed.), Sec. 962, p. 682; Note, *"Finality of Decree for Purposes of Review in the Supreme Court"*, 48 Harv. L. Rev. 302.

2. No Substantial Federal Question Is Involved

It is submitted that no substantial federal question is involved in the case at bar.

As has been pointed out, the machines in question were at all times within the state of Washington, and petitioners have at no time denied—they couldn't deny—that the sales tax and the business and occupation tax were properly payable upon what petitioners denominated as the "selling price" of the machines. The only dispute was as to the proper method of *computation* of the admitted state tax liabilities in issue. And questions relative to the proper method of *computation* of state taxes (as distinguished from questions relative to *applicability* of the taxes) are, we submit, essentially local questions, not federal ones.

Had petitioners sold their machines for a single, flat amount, there would not be and there could not be the slightest possible question but that the taxes in issue must be computed by the entire sales price. The arbitrary segregation by petitioners of the consideration payable by the purchasers of the machines into a basic price plus "royalties" results in no change in the substance of the transactions and should not have any effect on the tax liability involved. The abuses that could stem from any other result are obvious. As the state supreme court pointed out in this very case:

". . . While the amount paid by the purchaser at the time of the execution of the contract doubtless

> fairly represented the cost of the machine, and a reasonable maker's profit for the material and work required to build a machine, if taxes upon the amounts to be paid subsequently by the purchaser might be avoided by the method used, a vendor might, by a contract similar in substance, sell a machine, without the right to use it, for much less than its cost, and, by providing for the payment of 'royalties,' receive the greater portion of the cost of the machine by way of such payments." (R. 120, 121).

Especially in so far as the *minimum* "royalty" payments are concerned, the transactions in issue amounted to nothing more than sales on an installment basis, and those installment payments constitute part of the taxable selling price both as a matter of logic and of express statutory provision.

The Washington State sales tax statute defines the term "selling price" as meaning

> ". . . the consideration, whether money, credits, rights, or other property, expressed in terms of money, paid or delivered by a buyer to a seller, . . ." (Sec. 17(a), Chapter 180, Laws of 1935, as last amended by Section 4, Chapter 249, Laws of 1945; Remington's Revised Statutes, 1945 Supplement, sec. 8370-17(a)).

The "royalties" in question are part of the consideration paid by the buyers of the machines, and they therefore constitute part of the "selling price" under the explicit terms of the statute. The pertinent provisions of the business and occupation tax statutes are similar in effect. (See the definitions of the terms "gross proceeds of sales" and "value proceeding or accruing", which are quoted on p. 42 of petitioners' petition).

Furthermore, in so far as the sales tax is involved (and it represents the greatest proportion of the amounts in issue—the sales tax rate being 3%, whereas the occupation tax rate is ¼ of 1%), the tax is actually imposed upon the

buyer. Petitioners are simply required to collect the tax for the state, and any question as to the *amount* that they are required to collect under the laws of this state on sales to purchasers in this state can by no stretch of the imagination be said to involve any federal question. The fact that the state supreme court interpreted the admittedly applicable state statutes as requiring the collection of a larger amount of tax than petitioners originally thought collectible results in no more of a federal question or problem than would an increase in the amount to be collected which might result from direct legislative action. And in so far as the occupation tax is concerned, the court's attention is invited to the fact that petitioners' contracts with their vendees provided that the vendees would pay "all sales taxes *and other excise taxes payable on the sale.*" (R. 108, 120). [The citations are to portions of the state supreme court's opinions. The exhibits in the case were evidently not printed as part of the record, although they were included in the "Designation of Record for Certiorari". (R. 139). The forms of sales contract used by petitioners are Exhibit 8. (R. 17, 18.)] In view of the contractual provision just quoted, it would appear that our last comments relative to the sales tax situation are equally applicable to the business and occupation tax phase of this matter.

3. Answer to Petitioners' Arguments

a. Petitioners' argument re interstate commerce.

In the first subdivision of petitioners' argument, they argue that "these taxes are an illegal and unconstitutional imposition upon interstate commerce." In their attempt to establish that proposition, they ignore the facts that the machines in question were manufactured in this state and were sold to purchasers and users in this state and that they

(petitioners) have at all times admitted their basic liability for the taxes at issue, and they place practically their entire reliance upon the fact that the contracts of sale were accepted by petitioners in California.

A series of relatively recent decisions by this court, however, definitely establishes that the state in which delivery of the goods is effected has full jurisdiction to tax the transaction, despite the fact that the contract may have been accepted in some other state. Specifically, this court has upheld sales taxes, use taxes, and gross income taxes when imposed by the state in which delivery of the goods was effected, despite the fact that the orders were accepted in another state (and despite the further fact, we might add, that the goods themselves moved in interstate commerce). The pertinent decisions are:

Sales taxes:

McGoldrick v. Felt & Tarrant Mfg. Co., 309 U. S. 70, 84 L. Ed. 584, 60 S. Ct. 404 (1940); *Jagels, "A Fuel Corporation" v. Taylor*, 309 U. S. 619, 84 L. Ed. 983, 60 S. Ct. 469 (1940), affirming, *per curiam*, 280 N. Y. 766, 21 N. E. (2d) 526 (1940);

Use taxes:

Felt & Tarrant Mfg. Co. v. Gallagher, 306 U. S. 62, 83 L. Ed. 489, 59 S. Ct. 376 (1939); *Nelson v. Sears, Roebuck & Co.*, 312 U. S. 359, 85 L. Ed. 888, 61 S. Ct. 586 (1941); and *General Trading Co. v. State Tax Commission*, 322 U. S. 335, 88 L. Ed. 1309, 64 S. Ct. 1028 (1944); and

Gross income taxes:

Department of Treasury v. Allied Mills, 318 U. S. 740, 87 L. Ed. 1120, 63 S. Ct. 666 (1943), affirming, *per curiam*, 220 Ind. 340, 42 N. E. (2d) 34.

It is interesting to note also that in two of the cases just cited (*Jagels, "A Fuel Corporation" v. Taylor, supra*; and *Nelson v. Sears, Roebuck, supra*) the orders had not even been solicited in the taxing jurisdiction, which is an additional factor upon which petitioners appear to be placing some reliance here.

For additional decisions in which the taxing jurisdiction of the state of the buyer was upheld despite the fact that *the goods themselves* moved in interstate commerce, see:

Graybar Electric Co. v. Curry, 308 U. S. 513, 84 L. Ed. 437, 60 S. Ct. 139 (1939), affirming *per curiam*, 238 Ala. 116, 189 So. 186 (sales tax); *International Harvester Co. v. Dept. of Treasury*, 322 U. S. 340, 88 L. Ed. 1313, 64 S. Ct. 1019 (1944) (gross income tax); and *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U. S. 33, 84 L. Ed. 565, 60 S. Ct. 388 (1940) (sales tax).

b. Petitioners' argument re patent royalties.

The second and third subdivisions of petitioners' argument are both predicated, in effect, upon the contention that, in the language of the title of petitioners' third subdivision, the "patent royalties are not part of the selling price."

As we have already pointed out, the facts of the case refute that basic contention. The so-called "royalties" which the state supreme court held to be taxable as part of the selling price are the *minimum* yearly "royalties," which are payable to petitioners without regard to whether or not the machines are actually used. They are thus amounts that are payable by the buyers to petitioners as a result of the initial sale of the machines, and they consti-

tute part of the selling price as a matter of fundamental logic, to say nothing of the pertinent statutory provisions.

The only basis for petitioners' claim that these minimum "royalty" payments are not part of the selling price, is the self-serving fact that petitioners chose to label them as "royalties" in their contracts. In fact, however, the minimum annual payments are no different from an ordinary selling price which is payable in installments, and the different label that petitioners apply to those minimum annual payments cannot serve to convert a taxable portion of the selling price into non-taxable "royalties."

In addition, this phase of petitioners' argument is necessarily based upon the theory that *they* are being taxed improperly on *their* income from the so-called "royalties." But as we have already pointed out, the ultimate *sales* tax liability is upon the *purchasers*, and petitioners are merely required to collect the tax. The increased amount of tax that petitioners are required to collect under the decision by the state supreme court involves no more interference with their patent rights than did the collection of the lesser amount of tax as to which they at all times conceded their liability. And, again, by virtue of the provision in their contracts that the vendees would pay "all sales taxes *and other excise taxes* payable on the sale," (R. 108, 120), the same argument applies to the occupation tax involved.

The fundamental error in petitioners' argument is apparent from their citation of the case of *Newport Co. v. Wisconsin Tax Commission*, 219 Wis. 293, 261 N. W. 884, 100 A. L. R. 1204 (1935), as being "a case directly in point." The portion of that decision upon which petitioners rely involved the sale of patent rights as such—that is, the taxpayer sold those *intangibles* alone—and the court held that the intangibles had their situs at the domicile of the owner and that

the income from those sales therefore was not taxable in Wisconsin. In this case, on the other hand, we are concerned with *tangibles* which were manufactured and sold in the state of Washington, and the proceeds from the sales of which are *admittedly* subject to the taxes in issue, with the only question being whether or not the arbitrary designation of the minimum annual amounts payable by the buyers as "royalties" can serve to render them non-taxable, whereas if they were called installment payments of the purchase price there wouldn't be any question whatsoever as to the applicability of the taxes in issue. On the only real question in this case, i.e., as to the proper method of computation of taxes on the sale of *tangible* property manufactured and sold in this state, where part of the minimum consideration payable is arbitrarily designated in the contract as being a "royalty," the *Newport Co.* case, which petitioners refer to as "directly in point," has no bearing whatsoever.

c. Petitioners' argument re "doing business."

Petitioners contend that they were not doing business in the state of Washington, and therefore are not subject to local taxation here.

It will be noticed at the outset that this contention is entirely inconsistent with petitioners' basic position throughout this litigation, which was that it is only as to the so-called "royalties" that the taxes in issue do not apply. In so far as the sales involved the amounts which petitioners denominated as the selling price, the taxes were at all times collected and paid, and petitioners emphasized that fact repeatedly at all stages of the proceedings below. (R. 2, 9, 16, 21, 22, 23, 24, 39, 41, 42-43, 48, 71). To quote directly from the opening statement of counsel for petitioners at the trial of this action:

". . . The point in dispute here relates primarily, if not entirely, to whether or not the royalties for the use of the patented hop picking machines are taxable in this state. *So far as the three percent sales tax on what we call the original purchase price of the machine is concerned and the one-fourth of one percent occupation tax, there is no dispute as to that,* nor is there any dispute as to the relatively minor items of repair parts which are manufactured in California and shipped to this state, and which are subject to the three percent compensating tax, and those taxes have been fully paid. The dispute is as to whether or not the royalties are taxable. . . ." (R. 2).

The claim that petitioners were not doing business in this state is obviously inconsistent with petitioners' admission of liability with respect to "what [they] call the original purchase price," and this phase of their argument actually has no relevance to the only real issue in the case. Actually, the basic liability has at all times been admitted, and the only question has been as to the *extent* of the liability.

But aside from the inconsistency in petitioners' position, the record clearly establishes the fact that petitioners were, in fact, doing business in the state of Washington. The machines were regularly manufactured for them in this state. (R. 2, 34, 35, 84, 124, 127). The manufacturing operations were financed entirely by petitioners from a bank account which was maintained by them in this state. (R. 37, 49, 50, 87, 106, 107, 127). The machines and their component parts were at all times the property of petitioners, until sold (R. 29, 34-35, 105, 127), and were required to be, and were, insured for petitioners' protection (R. 85, 105). One of the petitioners regularly came to this state several times a year to test and inspect the machines during the course of construction. (R. 28, 88, 108). The royalties payable by users of the machines in this state were collected

and checked by a representative who is a resident of this state. (R. 61, 100, 110, 127).

Thus, petitioners regularly had machines, parts, a bank account, and a resident representative in this state. All of the activities were and are carried on as a regular course of business, and the substantial nature of those activities is indicated by the fact that the taxes voluntarily reported and paid by petitioners for the tax period in issue totalled $16,484.18 (R. 9).

In the light of the foregoing facts, which are not so much as mentioned by petitioners in this phase of their argument, the claim that they were not doing business in the state of Washington is clearly untenable.

CONCLUSION

Accordingly, it is respectfully submitted that the petition for certiorari be denied for the reasons that the proceedings in the state courts are not yet final and that no substantial federal question is involved.

Respectfully submitted,

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